

**STATE OF CALIFORNIA**  
**DEPARTMENT OF INSURANCE**  
45 Fremont Street, 21<sup>st</sup> Floor  
San Francisco, California 94105

**File No. RH03029826**

**Date: June 02, 2006**

**Notice File No. Z-05-1227-01**

**Title 10**  
**Proposed Revisions to Sections 2632.5, 2632.8 and 2632.11**  
**Optional Automobile Insurance Rating Factors**

**FINAL STATEMENT OF REASONS**

The Initial Statement of Reasons and Informative Digest were revised, in part, to explain why the proposed regulations are in harmony with, and not in conflict with or contradictory to, existing statutes, court decisions, or other provisions of law. The revisions also provide further explanation regarding the necessity for the proposed regulations. Thus, while the Commissioner disagrees with the reasoning of a decision of the Court of Appeal which interpreted Proposition 103 and Insurance Code section 1861.02, the Court recognized that there "may be no one single correct interpretation in this instance." (*Spanish Speaking Citizens' Foundation v. Low* (2000) 85 Cal. App. 4th 1179, 1186.) Indeed, the Court acknowledged that the Commissioner's proposed regulations reflect an interpretation of the relevant statutes which may be a permissible interpretation of applicable law. (*Spanish Speaking Citizens* 85 Cal. App. 4th at 1239.) Thus, the proposed regulations are in harmony and not in conflict with that decision.

**UPDATE OF INFORMATIVE DIGEST**

**Revisions have been made to the Informative Digest as follows:**

On pages 4-5 of the Notice of Proposed Action, the Policy Statement Overview and Effect of the Proposed Action was revised and now reads as follows:

"The proposed regulation would implement the provisions of Proposition 103 which require that rates and premiums for an automobile insurance policy shall be based primarily upon an insured's driving record, miles driven annually, and years of driving experience, rather than the area where a policyholder lives. The Commissioner has determined that the existing regulation is not consistent with either the express language of Section 1861.02(a) or the stated purposes of Proposition 103. The Commissioner is cognizant of the Court of Appeal decision in *Spanish Speaking Citizens' Foundation v. Low*, which held that the existing regulations lawfully implement the competing considerations of Proposition 103 and Insurance Code section 1861.02(a). While the Court in *Spanish Speaking* ultimately concluded that the existing regulations were a lawful choice among imperfect options, the Commissioner believes that the existing regulations are unlawful. The Commissioner, therefore, is rejecting the existing

regulation. The Commissioner believes that the proposed regulation correctly implements the requirements of Proposition 103 that automobile insurance rates shall be determined primarily by a drivers' safety record and mileage driven, which under section 1861.02(a) are to be more important in determining automobile insurance rates than the location of the driver's residence. The existing regulations require that the weight for all of the optional rating factors shall be averaged together. The average cannot be greater than the weight of the third mandatory factor. However, by definition, this means that an individual optional rating factor can, and frequently does, weigh more than one of the three mandatory factors. Thus the Commissioner believes that the existing regulations do not lawfully implement the requirements of section 1861.02(a)."

### **UPDATE OF INITIAL STATEMENT OF REASONS**

#### **Revisions have been made to the Initial Statement of Reasons as follows:**

On page 1 of the Initial Statement of Reasons, the first paragraph under the heading "§2632.8" now reads as follows:

"The Commissioner believes that the proposed revisions to the Commissioner's regulations are necessary to bring the existing regulations into compliance with Insurance Code section 1861.02(a), which requires that automobile insurance rates and premiums be determined by the application of rating factors in a specified order of importance, or weight. Section 1861.02(a) establishes the order of importance as follows: a driver's driving safety record must be the most important factor, followed by the driver's annual miles driven, followed by the number of years of driving experience for the driver, followed by those other optional factors that the Commissioner adopts through regulation."

On page 1 of the Initial Statement of Reasons, the second paragraph under the heading "§2632.8" now reads as follows:

"The current set of regulations provides that all of the optional rating factors, when averaged together, must not carry an average weight that is greater than the third mandatory factor of years of driving experience. Under that set of regulations, it is frequently the case that an individual optional rating factor carries more importance than a mandatory rating factor. The Commissioner has determined that the current regulations are not consistent with either the express language of section 1861.02(a) or the stated purposes of Proposition 103 and therefore must be amended."

### **SPECIFIC PURPOSE AND REASONABLE NECESSITY OF REGULATION**

On April 26, 2006, the Commissioner made available for public inspection certain changes to the regulation text as initially proposed. The Commissioner received a number of comments, and the summaries and responses to those comments are reflected within this Final Statement of Reasons. The changes to the regulation text were sufficiently related to the rulemaking action as originally noticed such that a reasonable

member of the directly affected public could have determined from the original notice that these changes could have resulted. (Cal.Code Regs., tit. 1, §42.) Each substantive change is listed below, in the same order as those changes appear in the regulation.

#### **Section 2632.5. Rating Factors.**

The Commissioner has revised the existing regulation text in subdivisions (d)(15) and (16). The new language increases the number of relative claims frequency and relative claims severity bands from ten to twenty. The new language is reasonably necessary because more than one commentator suggested that increasing the number of claims frequency and severity bands would allow insurers to classify risks more accurately. The more accurate classification of risks, in turn, will reduce the substantial differences in premium that the Commissioner observed for the same risk in neighboring zip codes. The new language, therefore, will aid insurers and further the Commissioner's aim to reduce the arbitrary differences in premium which were observed for regions of the state which exhibited similar risks.

The Commissioner has revised the existing regulation text in subdivision (e).

With respect to the first change, the word "Martial" represented a typographical error and was replaced with the correct word: "Marital". This is a technical, nonsubstantial change which does not materially alter the requirements, rights, responsibilities, conditions or prescriptions contained in the original text. (Cal.Code Regs., tit. 1, §40.)

The second change notifies the affected public that, under the limited circumstances in which insurers are permitted to combine optional factors with the mandatory factor of years of driving experience, each optional factor must still comply with the weight ordering requirements. Thus, the mandatory factors of driving safety record, annual mileage driven and years of driving experience cannot be outweighed by any individual optional rating factor – even when an optional factor is lawfully combined with years of driving experience. This revision represents a clarifying change and is reasonably necessary to uphold the requirement of Proposition 103 that the mandatory factors must be given greater importance than the optional rating factors adopted by the Commissioner.

#### **Section 2632.8. Factor Weights.**

The language of this section reflects two new changes.

First, in subdivision (a), the new language provides that particular automobile coverages may be considered in combination for purposes of complying with the rating factor weight ordering requirements of this section. Specifically, the new language informs the affected public that bodily injury coverage may be combined with property damage coverage. Similarly, the new language permits comprehensive coverage to be combined with collision coverage.

These revisions are reasonably necessary and are in response to the recommendations of a commentator. The revisions respond to the concerns raised by some commentators about the limited correlation between comprehensive coverage and the mandatory factors. The new language will enhance the relationship to the risk of loss for comprehensive coverage by giving insurers the option of combining that coverage with collision coverage; a coverage which bears a stronger correlation with the mandatory factors. Additionally, the new language recognizes that some insurers sell property damage and bodily injury coverages separately, while other insurers combine those coverages. By giving insurers the option to combine bodily injury coverage with property damage coverage for calculating the rating factor weights, insurers that use different techniques for complying with the weight ordering requirements will have greater flexibility to decide whether weigh the coverages separately or together.

Some commentators expressed uncertainty about whether an insurer would be given the discretion to pump or temper rating factors. Additionally, questions were raised as to whether an insurer could make adjustments to the mandatory factors for purposes of achieving proper rating factor alignment. The second new change is a reasonably necessary change which responds to these questions and clarifies the intent of the regulations. Therefore, subdivision (d)(4) has been added to this section and confirms that insurers may pump or temper either mandatory or optional rating factors as necessary in order to bring rating factor weights into the appropriate order of importance.

#### **Section 2632.11. Submission of Class Plans, Symbols, and Implementation Date**

The Notice of Proposed Action and Notice of Public Hearing solicited public advice regarding an appropriate transition period and phase-in process for the proposed regulations. After carefully considering the recommendations submitted by members of the public during the workshop and subsequent rulemaking hearing, the Commissioner identified an appropriate schedule for implementation of the proposed regulations.

The new language establishes that a minimum of two class plan and rate filings must be submitted which reflect the manner in which an insurer intends to comply with the regulations. As recommended by many commentators, the new language preserves substantial flexibility to each insurer to decide upon the most appropriate method for compliance. The new language allows insurers to refine and augment their rates through as many additional class plans as they deem necessary, so long as the insurer files the first class plan within 30 days of the date the regulations are filed with the Secretary of State and so long as the class plan is fully compliant with the weight ordering requirements of the regulations within two years thereafter.

The first class plan filed with the Commissioner must reflect that the insurer's rates will be at least 15% of the way towards full compliance with the regulations. In order to ensure a uniform standard of measurement, insurers are required to measure non-compliance based upon the class plan in effect for that insurer as of December 31, 2005. The extent of non-compliance is established by a formula substantially similar to that proposed by a commentator. Finally, as is the case with existing class plans, new class

plans must be implemented within 90 days of the date the class plans are approved.

The Commissioner gained substantial benefit from the carefully considered and thorough implementation proposals presented in the public comments. Consequently, the new language and implementation schedule reflect the adoption of many of the suggestions made by the public. The new changes to the regulations were reasonably necessary to establish a uniform and detailed schedule for implementation, including a set of defined parameters regarding the length of the transition period, and the transition process.

#### **UPDATE OF MATERIAL RELIED UPON**

No technical studies, reports or similar documents were relied upon by the Commissioner in proposing these regulations.

#### **MANDATE ON LOCAL AGENCIES OR SCHOOL DISTRICTS**

The Department has made a determination that adoption, amendment or repeal of the regulation does not impose a mandate on local agencies or school districts.

#### **ALTERNATIVES**

The Commissioner has determined that no alternative would be more effective in carrying out the purpose for which the regulations are proposed, or would be as effective and less burdensome to affected private persons than the proposed regulations. These regulations are designed to implement Proposition 103 and Insurance Code section 1861.02. While the Commissioner received a number of comments from the public, none of the comments presented a reasonable alternative to the regulations. Likewise, the Commissioner believes there is no reasonable alternative. Because no conceivable alternative regulations would be less burdensome to affected private persons without necessarily hampering the effective implementation of Proposition 103 and section 1861.02, or would be more effective in carrying out the purpose of ensuring that driving safety record, annual miles driven and years of driving experience are the most important factors for automobile rates, the Commissioner proposes these regulations for adoption.

#### **SUMMARY AND RESPONSE TO COMMENTS**

The summary and response to comments are organized and bound directly after this page.